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ABSTRACT

Beginning with the premise that postsecondary institutions in most states will suffer some sort of fiscal crisis in the 1980's, this paper discusses the strategies a state can use in contending with financial problems and turns to California's experiences after Proposition 13 for specific examples. After describing the two probable types of financial crisis, the paper focuses on the problems occurring when falling state revenues or tax and expenditure limitations force the reduction of institutional budgets without reference to enrollment. The paper then considers the different requirements of long- and short-term reductions and lists those budget areas and sources of revenue that are most readily available for state legislative action. Next, the paper suggests that states consider at least three options: (1) establish a discretionary fund for unanticipated emergencies; (2) consult with all concerned parties before making final decisions; and (3) require extensive reports on the effects of reductions. Part II focuses on California's post-Proposition 13 experiences. It begins by describing the bill, its effects on the revenue base of the community colleges, the state's immediate target budget, "bail out" approach, and the restrictions imposed by the Legislature on institutional budgeting. The paper then reviews the state's reductions for its college and university systems. Finally, conclusions are presented for states facing similar revenue shortfalls. (AYC)

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Managing Fiscal Crisis from the Perspective
of a Statewide Coordinating Agency:
The Case of California After Proposition 13

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Conference on Higher Education Financing Policies:
States/Institutions and Their Interaction

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There are two general types of fiscal crises, and educational institutions in most states will suffer at least one of them during the 1980's. The first crisis comes from declining enrollments in the face of formulas established during an era of expansion. The fact is that institutions cannot retrace their fiscal steps exactly and maintain any semblance of order or vigor. This type of crisis is less severe if states have developed formulas that accurately reflect the costs of adding students or the actual savings from enrolling fewer. The second type of crisis occurs when falling state revenues or tax and expenditure limitations force reductions of institutional budgets without reference to enrollment. Since the foundation of most formulas for public institutions rests on their predictable response to workload changes, this kind of crisis causes traumas to budgeting and planning which often exceed the dollar loss. My paper is concerned with this second crisis.

In contrast to the challenge of declining enrollments where certain approaches are clearly superior to others, there are few optimal ways for a state to impose reductions which are not workload related. Generally, these situations stem from limitations that legally reduce the State's ability to raise or spend revenues or

from an eroding tax base, which prevents all activities from being supported at their historic levels. Because these crises rarely allow adequate time for planning or discussion, most states impose reductions in an ad hoc fashion.

Despite this pattern, my central thesis is that some strategies are better than others when states consider emergency reductions in the budgets of their postsecondary institutions. My focus is not on how the state should determine the size of the total reduction, but on ways of imposing the reduction once its size is determined. This paper will describe these emergencies and possible state responses in general, and then turn for specific examples to California's experience after Proposition 13.

General Observations

Whether to specify the reductions or allow flexibility to the institutions is the central issue which every Legislature must decide during a fiscal crisis. Governing boards and administrators will ask for maximum freedom to impose cuts; special interests will urge that their programs be protected by statute. Where should the balance be struck?

Clearly, there is no optimum balance for all situations: much depends on each state's history and its current system of finance. One important consideration is whether the revenue shortfall will be short-term and temporary, or long-term and permanent. If temporary, across-the-board reductions or maximum flexibility are quite appropriate. If permanent, the State should first focus on its priorities among quality, diversity, access, research, and community services. Admittedly, this is a frustrating and unproductive exercise if conducted only in the abstract. However, once certain priorities are established and the dollar trade-offs among them are estimated, then details of funding and some specific actions should become more apparent. During a major crisis, it is important for the State to adopt a consistent strategy

that synthesizes its general priorities for all institutions and imposes reductions consistent with these priorities. Abandoning priorities and policies in order to reduce budgets across-the-board is a questionable strategy, especially if the reductions are likely to be permanent.

As a first step, it is important to consider the limitations on the State's effective action. Contracts and commitments to enrolled students impose serious limits on retrenchment in the short run. Realistically, those portions of institutional budgets or those sources of revenue, which are most readily available for legislative action, are the following:

--cost-of-living adjustments for salaries

--a hiring freeze

--inflation increases for operations and equipment

--faculty workload (student/faculty ratio)

--capital outlay

--tuition and fees

In choosing among these specific reductions or additional revenues, the missions of institutions are important. As an example, a priority to maintain "open access" and comprehensive community colleges suggests that large increases in tuition should be a strategy of last resort, even if Federal student aid will cover some of the increase. Alternately, if the State wishes to maintain the competitive ability of its distinguished research university, then salaries comparable with similar institutions takes on additional importance.

In responding to a fiscal crisis, a state should ponder at least three options. First, a discretionary fund specifically for unanticipated emergencies is a sound approach. The larger the reductions, the larger should be the fund. Second, the State should encourage consultation with all parties affected by cuts before the

institutions make their final decisions. Third, the Legislature should require extensive reports on the effects of reductions. These legislative strategies will not make the cuts less painful, but they can smooth the transition and provide for an informed review by the State.

The Experience of California

Proposition 13 added four hundred words to the California Constitution on June 6, 1978. The amendment established a maximum one percent tax rate of the "full cash value" for all property and defined "value" as that established for the 1975-76 fiscal year plus a two percent annual increase. It abolished all "over-ride property taxes" above the one percent level, and required a two-thirds vote at all levels of government to increase any tax. In terms of dollars, Proposition 13 eliminated $6.9 billion from the property tax collections projected for 1978-79, a 57% statewide reduction. In one day, the government of California lost almost one-fourth of its projected revenues from State and local taxes. The loss, of course, was off-set by estimates of a State budget surplus ranging between $3 and $5 billion.

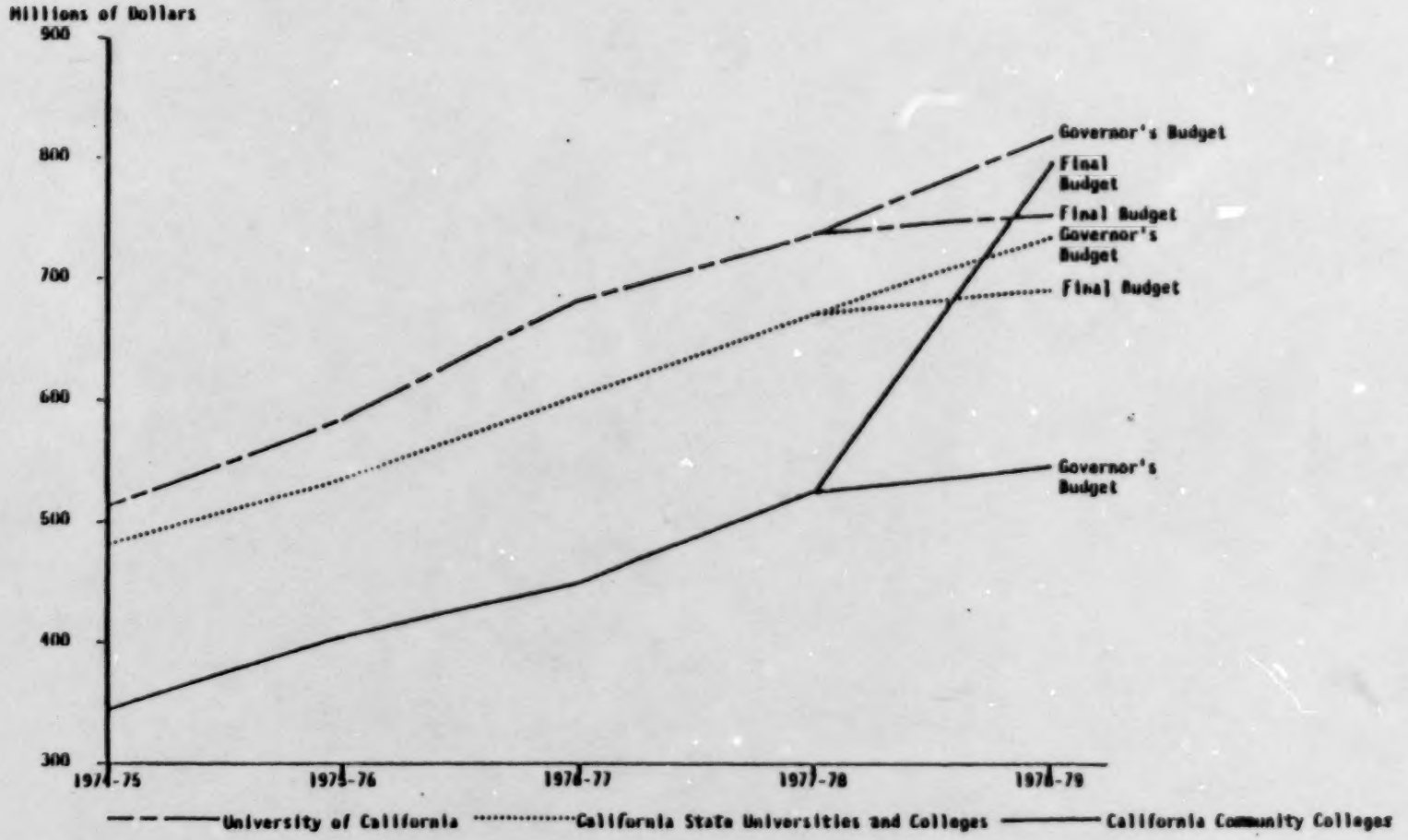
The Community Colleges had the most to lose since they were the only institutions of higher education which received property tax revenues. Proposition 13 drastically altered the system of Community College finance, not only by reducing property tax revenues, but also by making their collection countywide rather than districtwide, and by eliminating each district's authority to set its tax rate and to raise or lower that rate based on local circumstances. This local levy was the core support for the colleges because State apportionments had been based on the relative ability and willingness of the districts to tax themselves. By making the Legislature responsible for distributing property tax revenues, Proposition 13 destroyed the core of the finance system.

To meet the immediate crisis of Community College finance for 1978-79, the Legislature agreed in SB 154 to distribute the regular State apportionments projected for that year ($537 million) without regard to enrollment. In addition, the Community College districts received $260 million from the State's surplus, which was distributed according to a "target budget" approach. Before determining how much each district would receive from the surplus, its individual budget was calculated by adding its projected State apportionments, a certain percentage of its reserves (this came to be a small $20 million statewide), and its projected revenues from the remaining property taxes. Then, each district received enough of the $260 million to reach 85 percent of its 1977-78 budget, adjusted upward by 6.8 percent for inflation. Larger property tax revenues than originally expected meant that each district in 1978-79 received roughly 95 percent of its 1977-78 revenues in actual dollars.

Although the "target budget" approach immediately after Proposition 13 allowed districts to maintain most of their traditional discretion in budgeting, the Legislature did impose some significant restrictions. Districts could not use State apportionments to support certain noncredit courses, primarily recreational and avocational offerings. Except for these non-State funded classes, the Legislature continued its statutory prohibition against tuition for California residents. In addition, districts had to maintain a proportional level of service (85 percent of 1977-78 funding) in a dozen different programs the Legislature considered of prime importance. The Chancellor and the Community College system was authorized to distribute up to $15 million of the apportionments to insure that all colleges would remain open and that fiscal emergencies could be averted. Finally, no State funds would be available to districts that provided cost-of-living salary increases to their employees, a provision later declared unconstitutional by the State Supreme Court.

In sum, the State's approach to Community College finance in SB 154 was a hybrid. It was heavily influenced by the pattern of funding for the public schools, rather than by the pattern of that for the four-year segments. It reflected an unwillingness to shift property tax distribution at that time, a desire to maintain local governance, an insistence on statewide policies for salary adjustments, and a desire to protect certain legislative priorities. Most significant, the "bail-out" increased the State's proportion of Community College revenue up to 70 percent, even though the colleges received less total income for 1978-79 than for the previous year. This catapulted the Community Colleges from third to first among the three segments in terms of State revenues for current operations, as shown in the following graph.

SUPPORT FOR CURRENT OPERATIONS



The State's reductions for the University of California and the California State University and Colleges assumed a different form, partly because they received no property taxes and partly because they were funded in line items within the annual budget act. Published in January 1978, the Governor's Budget projected $819,177,000 for the University in 1978-79, including a 5 percent cost-of-living increase for salaries. Likewise, the Governor's Budget projected funding for the State University at $733,970,000, with a similar salary adjustment. The Legislature had not changed these levels significantly before Proposition 13.

The final Budget Act was quite different. Virtually all augmentations had been eliminated: the major reductions for the University came for instructional computing, equipment replacement, and research. On the other hand, the Legislature continued certain augmentations: faculty and staff development for affirmative action, a new program to train doctors in Watts, an outreach program for minorities in the public schools, and some funds to implement the University's ten year library plan. For salaries, the Budget Act provided "merit adjustments" but no cost-of-living increases. Further, members of the Legislature were unwilling to adopt the full extent of the Governor's recommended 5% reduction in the item "Operations Expense and Equipment," which they considered too arbitrary for higher education. Rather, they agreed to a compromise whereby a total dollar amount would be withdrawn from all State agencies after passage of the Budget Act, the exact proportion being negotiated with the Department of Finance. Finally, the Assembly Ways and Means Committee was concerned that the University of California had the constitutional autonomy to increase fees or impose tuition unilaterally and, alone among all the segments, to replace funds reduced after Proposition 13. After weighing alternatives, the Committee adopted budget language which reduced the University's General

General Fund appropriations by the amount of revenues received from any increase of fees or from the imposition of tuition. This provision was eliminated when the University's President promised not to increase fees.

The California Legislature adjourned on July 8, 1978, having distributed $4.2 billion of its surplus to replace lost property taxes and having reduced the State's projected expenditures by 7 percent. As the following table indicates, the budgets of the segments of higher education were not cut equally, but all experienced significant reductions in the wake of Proposition 13.

THE 1978-79 STATE BUDGET FROM ORIGINAL REQUESTS TO THE FINAL APPROPRIATIONS FOR THE SEGMENTS OF PUBLIC POSTSECONDARY EDUCATION IN CALIFORNIA

Segment	Requested by Governing Board	Amount in 1978-79 Governor's Budget	Percent Difference from Request	Amount in 1978-89 Budget Act	Percent Difference from 1978-79 Governor's Budget
University of California	$864,067,000[a]	$819,177,000	-5.2%	$752,645,000[c]	-8.1%
California State University and Colleges	$774,754,000[b]	$733,970,000	-5.3%	$691,934,000[d]	-5.7%
California Community Colleges -State Only	Not Applicable	$566,718,000	-----	$816,962,000[e]	+44.2%
California Community Colleges-State & Local	$1,212,780,202[e] (total income, 1977-78)	Not Applicable	----	$1,124,412,431[e] (total income, 1978-79)	Not Applicable

a. This includes a request for 9.3 percent increases in the Budget line item, Salaries and Fringe Benefits, over the 1977-78 level. The Governor's Budget provided a 5 percent increase which is included in the column to the right.

b. This includes a 9.9 percent increase in the Budget line item, Salaries and Fringe Benefits, over the 1977-78 level. The Governor's Budget provided a 5 percent increase which is included in the column to the right.

c. This amount is $15.4 million less than the University's line item amount in the 1978-79 Budget Act because of reductions authorized in Budget Control Sections 27.1 and 27.2. These reductions were negotiated between the University and the Department of Finance.

d. This amount is $14.1 million less than the State University's line item amount in the 1978-79 Budget Act because of reductions authorized in Budget Control Sections 27.1 and 27.2. These reductions were negotiated between the State University and the Department of Finance.

e. The Governor's Budget does not display an amount including property tax revenues for the Community Colleges. A reasonable estimate is that the $1.124 million actually received by the colleges in 1978-79 is roughly 15% less than they would have received without Proposition 13.

The consequences of property tax limitation and the State's response would take months, indeed years, to be fully apparent. It was clear, however, that Proposition 13 forced the Legislature and the Governor to make difficult decisions quickly, and they did so in a spirit balancing experimentation with caution. Even during the confused situation of June 1978, it was generally understood that most decisions could not be reversed easily. Although California's situation is unique in many ways, there appear to be some lessons which might prove instructive for states facing revenue shortfalls.

First, it was important to understand that the nature of the crisis was different for the three segments. Proposition 13 ended the system of "local" taxes for the Community Colleges by eliminating district control over property taxes. The State has yet to agree on a permanent system for their finance due to the dilemma of reconciling local authority over budgets with the State's right to control and monitor its appropriations. In contrast, reductions for the University and State University were compatible with their system of finance, it not with their stability as institutions. Further, the State's "bail-out" placed the Community Colleges first in State General Funds among the segments, and the implications of this change were not lost on the Colleges. "This may involve serious evaluation [by the State], in some ways for the first time, of the community college product," the Chancellor's staff told their Board of Governors.[1]

Second, the disruption of Community College finance and its feared impact on enrollment led the institutions to urge a "target budget" approach, without enrollment sensitivity, an approach which could provide some certainty in the face of large reductions. This is a very serious change in policy, even for only a year--

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1. California Community Colleges, Board of Governors, "Proposition 13," Agenda Item #3 (June 22-23, 1978), p. 6.

one which, in retrospect, should have been considered more carefully in California. Once enrollment-based funding was suspended, many districts were reluctant to return to enrollment funding and equalization, and lobbied later for a second year of "target budgets." Even during a major crisis, some kind of enrollment sensitivity for funding seems advisable, perhaps with some revenue loss maximum to protect institutions from percipitous declines.

Third, the State attempted to regulate the allocation process within the Community Colleges in unprecedented ways in 1978-79, primarily through "maintenance of effort" provisions and restrictions on salary increases. The "maintenance" provisions were a compromise: while the State avoided statewide standards for curricula, it did require that the districts live, in effect, with many of their 1977 curricular decisions. Although several districts objected to any restrictions on their flexibility, the "maintenance of effort" approach during a crisis appears to be a reasonable accommodation between State priorities and institutional control.

More important, however, is the reality that even if the Legislature had included none of the 1978 restrictions, each district's flexibility would have been seriously limited by the many provisions in California's Education Code which mandate certain activities or prevent lay-offs. Because of these restrictions, not the mandates of 1978, the response among districts was remarkably similar: large numbers of non-tenured faculty were released and major reductions were imposed on community, student, and academic services--areas not protected by existing law. If a state wishes to provide more flexibility to its institutions during a crisis, it should consider all laws which apply to them, and not deal only with provisions in the funding formula.

Finally, cost-of-living adjustments were an attractive reduction because they represented a large amount of money, identified in a single line item. Further,

their loss did not force institutions to cancel courses or dismiss personnel. However, California's experience suggests that pressures for salary increases will grow irresistibly after a freeze, and that a large salary increase--or destructive turmoil within the institutions--is likely soon. Although alluring as a temporary expedient, a salary freeze is a poor device if used to avoid program or personnel reductions, especially if the fiscal limits are permanent.

Proposition 13 has forced California to consider seriously its priorities among quality, diversity, access, research, public service and community activities. Given the State's tradition of educational opportunity and its strong economy, this has been a new and agonizing experience, even though Proposition 13 and its ballot successors have not inflicted the havoc widely feared. Nevertheless, there is a growing conviction that priorities and the trade-offs among them are a prime order of statewide business during the early 1980's.

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